

Office of Inspector General

Audit of FCA's Financial Statements
Fiscal Year 2005



November 2005

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For the financial statements and related notes to each fiscal year's financial audit report, refer to FCA's Performance and Accountability Report (PAR) for that year. The PARs can be found at www.fca.gov/reports/performance_reports.html.

Farm Credit Administration

Office of Inspector General
1501 Farm Credit Drive
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November 4, 2005

The Honorable Nancy C. Pellett
Chairman of the Board
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Chairman Pellett:

This letter transmits the report on the audit of the Farm Credit Administration's (FCA or Agency) financial statements for the fiscal year ended September 30, 2005. The Office of Inspector General (OIG) contracted with Harper, Rains, Knight, & Company, P.A. (HRK), an independent accounting firm, to perform the audit. This letter also incorporates a summary of what I believe are significant management and performance challenges facing the Agency. I also described these challenges in the OIG Semiannual Report to the Congress dated September 30, 2005.

HRK issued an unqualified opinion. HRK opined that FCA's principal financial statements present fairly, in all material respects, the financial position of the Agency as of September 30, 2005 and 2004, in conformity with generally accepted accounting principles. HRK issued two other reports. Its report on internal control noted no matters considered to be material weaknesses. The HRK report on compliance with laws and regulations does not note any instances of noncompliance. In our opinion, HRK's work provides a reasonable basis on which to render its opinion and we concur with the reports.

The contract with HRK required that they perform the audit in accordance with "Government Auditing Standards" issued by the Comptroller General of the United States and the Office of Management and Budget Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements." To ensure the quality of the work performed, the OIG:

- reviewed HRK's approach and planning of the audit;
- evaluated the qualifications and independence of the auditors;
- monitored progress of the audit;
- examined working papers;
- and reviewed the audit report.

As part of the Agency's annual Performance and Accountability Report, the Inspector General is required to provide an opinion on the most serious management and performance challenges facing the Agency. In the most recent OIG Semiannual Report to Congress, I outlined substantive challenges confronting the Agency. These challenges fall into two general categories. First are the challenges related to the FCA's mission of ensuring a safe, sound, and dependable Farm Credit System (FCS or System) as a source of credit and related services to agriculture. Some of these challenges may be influenced by events that are outside the control of the Agency. Second, but no less important, are the challenges related to the Agency's operations.

FCS – The System lends to a single industry that is vulnerable to economic swings. Nevertheless, the FCS remains sound in all material respects. Earnings and capital levels continue to be strong and asset quality remains high. However, there are many facets of agriculture and rural America today that raise the question of whether there should be modifications to the Farm Credit Act of 1971, as amended (Act), in order to enhance the agricultural and rural economies of the future.

The FCA and the System have a responsibility to inform Congress when there is a need to update the Act in order to ensure the FCS is able to continue to provide constructive and sufficient credit and related services to agriculture into the future. Ensuring that Congress is so informed will require a consistency in approach and strategic thinking on the part of the Agency and the System to assist Congress in maintaining the Act as a dynamic and empowering vehicle for the ultimate benefit of America's farmers, ranchers, and other rural citizens.

FCA – The FCA must balance the demands of ensuring the FCS fulfills its public policy purpose; proactively examining System institutions for undue risk and weaknesses in governance and management; and yet providing a flexible regulatory environment for FCS institutions within the provisions of the Act. This challenge has become increasingly difficult because of the ever changing nature of agriculture, lending, and the financial marketplace.

In adapting to meet this changing landscape, the FCA Board must be ever vigilant to ensure the Agency's continued independence and objectivity as the System's safety and soundness regulator.

Strategic Planning – The FCA Board adopted its 2004-2009 Strategic Plan in December 2003. Since adoption, the Agency has a new Chairman and a new FCA Board member. These changes in leadership provide an opportunity to revise the plan to ensure that the current FCA Board's vision is fully incorporated.

The FCA Board refined the Agency's performance measures in January 2005. The performance measures should be evaluated on an ongoing basis to ensure they challenge and stretch the organization. An effective performance management system fosters achievement and accountability at the individual, organizational, and overall Agency levels.

Agency Governance – The Act provides for a full-time three-member FCA Board. The members are appointed by the President and confirmed by the Senate. For a relatively small agency, this board structure presents a challenge in defining the roles and responsibilities of the members relative to the governance of the Agency.

The Chairman took action to address this challenge by sharing authority in tasking another member with leading the FCA Board in its efforts on governance issues. This tasking applies to governance within both the Agency and System institutions. One significant result thus far was a collaborative review by the members of all FCA Board policies and the revision of many, including the FCA Board's operational policy. This updated operational policy now captures the current rules and processes related to the FCA Board's transaction of business. To govern the Agency effectively, the FCA Board must be able to engage in professional policy debate in an environment of mutual trust and shared expectations. A foundation for achieving this is the FCA Board's revised operational policy.

Human Capital - In March 2001, the OIG recommended FCA develop a human capital plan. FCA management agreed to this recommendation. Under Chairman Pellett, Agency managers have focused on the challenge of marshalling and managing human capital to assure accountability and maximize FCA performance. While FCA still does not have a human capital plan, the Agency has made a significant investment in strategic studies that can serve as the plan's foundation. The objective of the strategic studies was to create a picture of the credit needs of the System and rural America in the intermediate- and long-term future and identify organizational and human capital opportunities to help FCA adapt. The approach is in marked contrast to the past where we noted the problem was the lack of a strategic approach in establishing a human capital plan.

FCA has transformed the strategic studies into management actions such as organizational changes, the realignment of human resources, and process improvements. These management initiatives should facilitate the development of a human capital plan that incorporates the elements recommended by the OIG in March 2001 and the optimal utilization of human capital.

Another challenge facing the Agency and a critical component of managing human capital is providing for management succession. Individuals with the potential to become managers should be identified, provided developmental opportunities, and, after demonstrating managerial capability, ultimately promoted to higher positions. This, as part of a human capital plan, should be linked to the Agency's Strategic Plan and is critical in the Agency's ongoing accomplishment of its mission.

Financial Management – Timely, accurate, and useful financial information is essential for:

- day-to-day decision-making;
- managing the Agency's operations more efficiently, effectively, and economically;
- supporting results-oriented management approaches; and
- ensuring accountability on an ongoing basis.

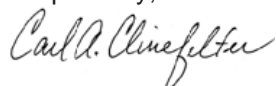
During FY 2001, FCA successfully implemented a financial management system. During September 2003, the Agency decided to purchase a new financial system. Management originally scheduled implementation of the new system during FY 2004. In September 2004, the OIG issued an inspection report that showed significant improvements were needed in the project management of this new financial management system to successfully complete implementation. In July 2005, this project was put on hold awaiting a reevaluation of this new system.

The Agency's continuing challenge is to outsource or bring yet another financial management system on line at a reasonable cost to FCA and concurrently leverage the system to deliver timely financial information, critical for making well informed management decisions. The challenge suggests the Agency should develop measures of financial management success beyond receiving an unqualified financial statement audit opinion, as stated in the FCA 2004-2009 Strategic Plan. Measures such as delivering financial information that managers can use in day-to-day operations, and developing reports that capture the full cost of programs and projects can help bring about improvements.

Leveraging Technology - Information technology (IT) is a key element of management reform efforts that can help dramatically improve performance and reduce costs. The Agency has recognized that in order to meet the constraints of its budget, it must be able to maximize its return on investment in technology. FCA's challenge is to establish effective mechanisms to ensure that current and future members of staff have the skills to use technology to operate in an efficient and effective manner. Internally, there is an opportunity for IT to complement human capital initiatives to reformulate the work processes of FCA. There is also an opportunity to capture knowledge of employees who are approaching retirement. In order to take advantage of these opportunities, FCA will need to invest in training and reward employees who are able to develop innovative approaches in using technology to accomplish Agency goals.

Externally, E-Government offers many opportunities to better serve the public. FCA's challenge is to identify opportunities to make FCA more efficient and effective, and reduce costs through the use of E-Government strategies. FCA has begun to implement some E-Government applications, including the use of the Internet to collect and disseminate information and forms.

Respectfully,



Carl A. Clinefelter
Inspector General



INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

FARM CREDIT ADMINISTRATION
The Board and Office of Inspector General

We have audited the balance sheets of the Farm Credit Administration (FCA) as of September 30, 2005 and 2004, and the related statements of net cost, changes in net position, budgetary resources, and financing for the fiscal years then ended. These financial statements are the responsibility of the FCA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial statements contained in Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements." Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and net position of the FCA as of September 30, 2005 and 2004, and the net cost, changes in net position, budgetary resources, and reconciliation of net cost to budgetary resources for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the fiscal year 2005 and 2004 principal financial statements of the FCA. The accompanying financial information, discussed below, is not a required part of the principal financial statements.

The Management Discussion and Analysis on pages 2 through 20 and the Required Supplemental Information on pages 68 through 70 is supplementary information required by the Federal Accounting Standards Advisory Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the information. However, we did not audit the information and express no opinion on it.

Harper, Rains, Knight & Company, P.A.

October 28, 2005



INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

FARM CREDIT ADMINISTRATION

The Board and Office of Inspector General

We have audited the Principal Statements (hereinafter referred to as "financial statements") of the Farm Credit Administration (FCA) as of and for the fiscal years ended September 30, 2005 and 2004, and have issued our report thereon dated October 28, 2005. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

In planning and performing our audits, we considered FCA's internal control over financial reporting by obtaining an understanding of the agency's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audits was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. However, we noted no matters involving the internal control and its operation that we considered to be material weaknesses as defined above.

With respect to internal control related to performance measures reported in the Performance Report, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

This report is intended solely for the information and use of the management of FCA, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Harper, Rains, Knight & Company, P.A.

October 28, 2005



INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

FARM CREDIT ADMINISTRATION

The Board and Office of Inspector General

We have audited the Principal Statements (hereinafter referred to as "financial statements") of the Farm Credit Administration (FCA) as of and for the fiscal years ended September 30, 2005 and 2004, and have issued our report thereon dated October 28, 2005. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

The management of FCA is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether the agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 01-02, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to FCA.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph exclusive of FFMIA disclosed no instances of noncompliance with laws and regulations that are required to be reported under Government Auditing Standards and OMB Bulletin No. 01-02.

Under FFMIA, we are required to report whether the agency's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

The results of our tests disclosed no instances in which the agency's financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audits and, accordingly, we do not express such an opinion.

This report is intended solely for the information and use of the management of FCA, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Harper, Rains, Knight & Company, P.A.

October 28, 2005

R E P O R T

Fraud | Waste | Abuse | Mismanagement



FARM CREDIT ADMINISTRATION
OFFICE OF INSPECTOR GENERAL

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